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NABE Policy Survey

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Business Economists Want Action Taken to Reduce the Federal Budget Deficit and to Address the FSLIC Problem

This report presents the results of a survey on economic policy issues made by a panel of nearly 200 business economists in mid-November. The **Economic Policy Survey** is one of three surveys taken during each calendar quarter by NABE; the other surveys are the **Industry Survey** and **NABE Outlook**.

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The November 1988 policy questions were received by the policy panel shortly after the general election. The questions focused on what economic priorities the new Bush administration should have.

Survey Highlights

* NABE's panel of business economists overwhelmingly indicated that reducing the Federal budget deficit should be the number one priority of the Bush administration. Some combination of higher taxes and lower spending received the greatest support.

* President-elect Bush's proposal of a flexible freeze received only mixed support, with most panelists not ranking it as the most urgent priority.

* Other methods of reducing the Federal budget deficit, such as a line item veto or a constitutional amendment to balance the budget, were viewed as being moderate to low priority items.

* Also high on the priority list was a resolution to the FSLIC problem. Removing barriers for the buyers of insolvent thrifts and indexing thrift deposit insurance fees to the riskiness of loans and deposits were highest on the list of recommended solutions.

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CUTTING THE BUDGET DEFICIT HAS THE HIGHEST PRIORITY

The panel was presented with 15 different policy actions that the new Bush administration could take, and was asked to rank each one in terms of urgency. The results showed that NABE members felt that reducing the Federal budget deficit through a combination of tax increases and spending cuts had the highest priority. The questions were worded so that there were four choices for cutting the budget deficit: (1) only raise taxes, (2) only cut spending, (3) raise taxes and cut spending, and (4) do not raise taxes and limit spending to the rate of inflation (the "flexible freeze"). The flexible freeze and reducing the deficit by only cutting spending also received some support. Interestingly, although the alternative of only cutting spending had more supporters than the flexible freeze (54 percent of respondents compared with 48 percent), it also had a significantly higher number who ranked it as the lowest priority (46 percent versus 26 percent).

Economic Policy Priorities
for the Bush Administration
(in Descending Rank Order of Priority)

Policy	Weighted Score
Budget deficit reduction through lower spending and higher taxes	3.90
Address the FSLIC problem	3.84
Budget deficit reduction through the flexible freeze	3.34
Reform the budget process	3.29
Lower the trade deficit	3.23
Budget deficit reduction only through lower spending	3.12
Legislation for a line-item veto	3.05
Address the third-world debt problem	2.93
Lower the marginal tax rate on capital gains	2.49
Legislation for general tax reform	2.40
Increase regulation of mergers and acquisitions and leveraged buyout activities	2.34
Legislation for new housing programs for the homeless and low-income families	2.31
Seek a balanced budget amendment to the Constitution	2.13
Budget deficit reduction only through higher taxes	1.75
Move to a fixed exchange rate system	1.40

Based upon responses ranging from 1=Least Urgent to 5=Most Urgent

The panel responses can be put into four main groups. The group with the highest scores had only cutting the deficit through a combination of tax increases and spending cuts and addressing the FSLIC problem as elements. Only the deficit cutting measure, however, had a median response of highest priority -- with over 50 percent of respondents placing it in the highest priority category.

The second group of priorities includes all of those with scores between 3.34 and 2.93. This group of six items included four that were aimed, either directly or indirectly, at cutting the budget deficit. In addition to the flexible freeze, they included cutting the deficit only through spending cuts, reforming the budget process, and providing the President with a line-item veto. Clearly, cutting the budget deficit was of paramount importance to the NABE panel. Lowering the trade deficit and addressing the third-world debt problem were also in this upper middle group.

The third group included a broad array of proposals that each received some support as a second, third, or fourth priority item. However, each of these programs also had a large number of respondents who ranked it as a lowest priority. These programs included the two tax change proposals, increased regulation for M&A activities, legislation for the homeless, and, perhaps surprisingly given the strong sentiment to reduce the budget deficit, the balanced budget amendment.

The bottom group of programs were clearly at the tail end of most of the respondent's lists. Nearly 60 percent of respondents listed lowering the budget deficit only through raising taxes in the lowest priority category, while more than 77 percent put a return to fixed exchange rates in there as well.

Monetary Policy

More than 80 percent of the NABE panel felt that in light of recent money growth rates, recent reserves growth rates, and the recent level of the federal funds rate that monetary policy was now "about right". About 12 percent found recent policy too restrictive, while the remaining 7 percent found it too stimulative. This is in contrast to the survey of two month's before which found 23 percent feeling that policy was too stimulative at that time and 6 percent labeling policy as too restrictive. Also in contrast to the last policy survey, only 32 percent thought that recent money growth rates were a good measure of the thrust of monetary policy, compared to 56 percent in September. Nearly 51 percent now find the level of the federal funds rate to be a good measure of monetary policy.

Nearly one half of the panel expects that Federal Reserve monetary policy will be influenced most by inflation and inflation expectations over the next six months. A sizable group of about 30 percent thinks that the pace of economic expansion will dictate the Fed's policy over that period. About 16 percent believes that the exchange value of the dollar will most influence monetary policy. Only 1.6 percent thinks that the Fed still has any monetarist leanings, expecting the Fed to react to the rate of money stock growth.

Over 60 percent of the panel felt that the Fed would be tightening monetary policy over the next six months. They disagreed, however, on the strength of that tightening, with slightly more than half of that group feeling that the Fed would push up the federal funds rate but not raise the discount rate. The other half of this group believed that the Fed will be more severe in its tightening, expecting that the Fed will raise the discount rate one or more times in addition to pushing up the federal funds rate. About one quarter of the respondents felt that the Fed would leave policy basically unchanged over the next six months, while a very small minority thought that the Fed would actually ease policy over that time.

The last question on monetary policy asked the panel what the Fed should be concentrating on in its conduct of policy. Since the respondents were allowed to choose more than one indicator, there were several that scored highly. Three of the indicators gained more than half of the panel's support: recent inflation movements (65.6 percent), growth in real GNP (60.6 percent), and recent movements in the dollar (52.8 percent). The federal funds rate drew moderate support, with more than 45 percent of the panel favoring it. The monetary aggregates drew only modest support, with nearly 37 percent favoring targeting M2 growth, about 28 percent favoring targeting M3 growth, 26 percent in favor of targeting monetary base growth, and only about 18 percent favoring targeting M1. Other possible targets that have been in the news lately did not have strong support -- the shape of the yield curve had support from only 24 percent of the panel and recent commodity price movements gained backing from only 19 percent.

The FSLIC Problem

The NABE panel felt that the problem with FSLIC is a serious one, but the respondents differed on the urgency of rescuing FSLIC. Only 28 percent of the panel responded that regardless of tne cost it was very urgent that FSLIC be rescued. About 30 percent shared the urgency of that first group, but only if there were little or no budget impact. The largest group of respondents replied that the problem was important, but not something to rush into. The overwhelming conviction by the panel members that the Federal budget deficit was the nation's first priority appears to have had a major impact on their responses to the FSLIC problem. Virtually the entire panel felt that the problem was either important or urgent, but nearly 70 percent either wanted no budget impact or more study.

The panel was given thirteen possible ways in which to deal with the FSLIC problem, and they were asked to rank each proposal from least to most favorable. There was one clear favorite among the proposals, and several other recommendations rated highly. Indexing thrift deposit insurance fees to the riskiness of loans and deposits was the only proposal to generate more than half the responses in the most favored category, resulting in an average score of 4.09 (on a scale of 5 for most favorable and 1 for least favorable). This proposal would reduce the moral hazard problem resulting from the current system of uniform deposit insurance rates regardless of asset risk. Also ranking highly were removing barriers for prospective purchasers of thrifts -- especially for insolvent thrifts -- and mandating that thrifts must price assets at market value.

Recommendations for Solving the FSLIC Problem (in Descending Rank Order of Priority)

Recommendation	Weighted Score
Index thrift deposit insurance fees to the riskiness of loans and deposits	4.09
Remove barriers for buyers of insolvent thrifts	3.85
Force thrifts to price assets at market value	3.53
Remove barriers for buyers of any thrifts	3.36
Prohibit, or severely limit, the ability of insolvent thrifts to compete for assets with healthy thrifts	3.13
Give explicit government backing to the debt market instruments of FSLIC	2.80
Prohibit, or severely limit, brokered deposits	2.62
Merge the FSLIC and FDIC insurance funds	2.41
Sell the assets of Freddie Mac and use the proceeds to refinance FSLIC	2.29
Use general revenue funds to refinance FSLIC	2.17
Place an excise tax on junk bonds and use the proceeds to refinance FSLIC	2.08
Pay interest on deposits at the Fed by depository institutions and use the proceeds to refinance FSLIC	2.05
Increase the special levy on solvent thrifts	1.92

Based upon responses ranging from 1=Least to 5=Most Favorable

Despite the importance that the panel placed on solving the FSLIC problem, the results clearly showed that any solution that involved raising the Federal budget deficit would have a very low priority. Nearly 45 percent of the panel gave the least favorable response when asked if general revenue funds should be used to refinance FSLIC. And even giving explicit government backing to FSLIC's debt -- which would only result in a charge to the government in the case of FSLIC's default -- was only modestly favorable to the respondents (with a mean score of 2.80 but with nearly 25 percent of the panel putting it in the least favorable category). The lowest scoring proposal in the group was for increasing the special levy on solvent thrifts in order to refinance FSLIC. Nearly 50 percent of the respondents put this in the least favorable category.

Trade and the Dollar

The final section of questions was on the trade deficit and forecasts of the exchange value of the dollar. In the time between when the questions were written and the responses received, the dollar fell significantly. This may help explain why 60 percent of the panel felt that the dollar would be little changed (within five percent of its December 1987 value) at the end of 1988 despite being 7.2 percent higher at the end of October. The remaining 40 percent were fairly evenly split between those who thought that the dollar would fall by more than 5 percent (24 percent of respondents) and those who felt that the dollar would rise by more than 5 percent (16 percent).

When asked what the equilibrium value of the dollar would be at the end of the year (presumably the exchange rate that would occur if all central bank intervention were eliminated), more than half of the panel felt that it was between 5 and 20 percent below current levels (those in mid-November). Twenty seven percent of the panelists felt that the equilibrium value of the dollar was within 5 percentage points of its current level, and about 13 percent thought that the equilibrium value was more than 5 percent above current levels.

The forecasts for the change in the dollar in 1989 corresponded very well with the responses for the equilibrium value of the dollar at the end of 1988. Presumably this reflects the NABE panel's belief that over the longer run forces in the international economy would push the dollar towards its equilibrium value. Nearly 57 percent saw the dollar between 5 and 15 percent lower at the end of 1989, while about 24 percent felt that it would be nearly unchanged. A little more than 14 percent predicted that the dollar would rise more than 5 percent next year.

The final two questions were on the causes and solutions for the merchandise trade deficit. A plurality of the respondents, 37 percent, felt that the Federal budget deficit was the primary cause of the trade deficit. The next most popular response, 20 percent, was that a better investment climate and opportunities in the U.S. compared to those opportunities abroad caused the deficit. Relatively faster economic growth in the U.S., relatively higher real interest rates in the U.S., and unfair trading practices abroad had successively fewer responses. Interestingly, this question was the only one in the survey that generated a substantial response to "other", with 19 percent of the panel members feeling that the trade deficit was primarily caused by some reason other than the choices presented.

In finding the best way to eliminate the trade deficit, the clear favorite was to cut the Federal budget deficit, with more than 41 percent of the panel choosing it. Encouraging a further drop in the dollar -- presumably through "jaw boning" or central bank intervention -- was the choice of nearly 21 percent of the NABE panel. Further expansion of free trade through the Uruguay round of GATT negotiations was favored by 18 percent of the respondents. None of the other choices received significant support, with only 1 respondent choosing to unilaterally restrict foreign imports.